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WAVES ON A BEACH

LIKE the waves on a beach, which they are said to resemble, trends in financial markets never proceed in a straight line. Every advance is followed sooner or later by a retreat; every gain (or loss) is apt to be corrected. Thus the upsurge in money rates which began late last spring has been interrupted twice: for eight or ten weeks last fall and, again, since the turn of the year. However, sooner or later -- if, indeed it hasn't already begun -- the swing toward higher interest rates is bound to resume.

The latest respite set in toward the end of January, when yields of all kinds hit their highs (to date, anyway) for the year. In the weeks that followed, the return on fixed income obligations of all kinds tended either to level off or to decline. For example, from a January peak of 3.03%, 13-week Treasury bills at the end of last month sold at only 2.80%. Other short-term securities, notably commercial paper and finance company paper, followed suit. By the same token, the prices of seasoned corporate and municipal bonds generally tended to firm during February. Hence, average yields on Moody's Aaa-rated issues slipped from 4.16% to 4.13%, while those on seasoned municipals eased from 3.20% to 3.11%.

Finally, secondary market prices for FHA-insured home mortgages held firm in January-February. According to the agency, on March 1 the national average price per $100 of mortgage credit stood at $97.4, up a bit over the $97.3 which prevailed on December 1, 1958. On a regional basis, the sole decline in February was reported for the North Central part of the country. The averages were unchanged in the Southeastern and Western States, and ranged from 1/10 to 2/5 of a point higher throughout the rest of the U. S. (the biggest gain was recorded in the Northeast).

Several factors account for the recent rally in debt instruments. For one thing, contrary to general expectations, flotations of corporate and municipal securities alike since the turn of the year have lagged behind volume in the comparable months of 1958. In January-February, sales of tax-exempts totaled $1.5 billion, down from the record-breaking $1.7 billion of the like year-ago period. New corporates were off still more sharply. Meanwhile, considering the rapid pick-up in industrial production and retail trade, savings have continued to run relatively high. To be sure, life insurance companies

and savings banks lately have reported a slackening in the rate of asset growth. In January-February combined, however, the U. S. Savings and Loan League reported the other day, net savings of their member institutions ran to an estimated $829 million, barely 1% below the record level of the previous year. In February alone, preliminary data suggest, S & Ls actually showed a 3% gain.

A third reason for the rally is cited by some knowledgeable observers -- the very rapid increase in the liquidity of nonfinancial corporations. Corporate treasuries in recent months have benefited both from the steady accrual of rising depreciation reserves and, more importantly, from the unprecedented jump in profits. Such funds have succeeded in finding their way into the money market, either in search of short-term obligations or, through the expanding operations of money brokers, as speculative credit for the purchase of longer-term issues, notably convertible debentures. One way or another, funds of this kind have tended to buoy demand.

Finally, the rally has been helped along by a small but perceptible slackening of inflationary fears. The change has been due in part to the unexpected determination to fight for a balanced budget which the White House has displayed, as well as by mounting signs -- in such fields as airport construction, unemployment compensation and housing -- that such efforts will not prove wholly fruitless. It also has stemmed from a certain amount of uneasiness regarding the strength of the comeback in business activity, as well as over the continuing high level of unemployment. This uncertainty, by the way, is shared by at least one influential member of the Federal Reserve Board. Barely a fortnight ago, Governor M. S. Szymczak said that the number of idle was one reason for the "neutral" credit policy which the money managers, at the time, seemed to be pursuing.

Early this month, however, the Board unmistakably made up its mind. With its blessing, several leading FR District Banks, effective March 6, raised their discount rates from 2½% to 3% (all twelve district banks now have followed suit). A rapid, if limited, adjustment in other short-term rates ensued. Thus, major sales finance companies have upped rates on 120-179 day paper and 240-270 day paper by 1/8 to 1/4%, respectively. Dealers in bankers' acceptances and commercial paper have done the same. Similarly, to fit the new pattern of yields, long-term corporate and municipal bonds have declined by a point or two during the past two weeks.

The adjustment in the market, it should be noted, thus far has been relatively small. Indeed, demand for short-term securities remains so brisk that at the latest weekly auction held by the Treasury, bills sold to yield no more than they did prior to the increase in the discount rate. Some further period of stability, owing to the forces cited above, may be in prospect.

Over the longer pull, however, the facts still point to higher rates. As noted, the monetary authorities lately have begun to tighten up again. The rise in the discount rate has been followed by open market operations designed to reinforce the move. According to the latest statement of the weekly reporting FR member banks, their net borrowed reserves have doubled, from an average of $100 million per week to $200 million. Last summer, it will be recalled, commercial banks enjoyed surplus reserves averaging around $100 million per week. By the same token, on Friday the 13th, appropriately enough, the FRB proposed a set of changes in rules governing the buying of stocks and convertible bonds on margin. While details remain to be ironed out, the new rules undoubtedly will curtail, to some extent at least, the flow of credit into the securities marts.

Another element working to depress bond prices is the plight of the U. S. Treasury. Within the next week or so, the Treasury will offer securities designed to raise $3½-$4 billion in cash. While most observers expect the offering to consist wholly of tax anticipation bills, certificates, or notes, uncertainty over the exact terms is likely to keep pressure on the market. The Treasury, it should be recalled, earlier this year sold $750 million of 4% bonds, due in 1980. A determined effort to stretch out the debt probably would require the Administration to seek an increase in the current ceiling of 4½% on long-term Government issues, a move which undoubtedly would have a bearish impact on all maturities. Beyond the current Treasury flotation, moreover, loom several others, tentatively scheduled for May and June. Successive Treasury offerings, in short, will continue to overhang the market throughout most of the spring.

Other borrowers, too, are likely to be queueing up in strength at the commercial banks before long. The early months of any year, to be sure, are a period of seasonal slackness in demand for credit. Nineteen hundred fifty-nine is proving no exception. However, it is worth noting that loan demand this year has declined less than either last year or the year before. To illustrate, since January 1, banks in 93 cities outside of New York report that commercial, industrial and farm loans have declined by $638 million. In 1958, by contrast, such loans plummeted by nearly $1.5 billion, and in 1957, when business was near its peak, the decline was $650 million. Again, after keeping a tight hold on its purse strings throughout most of 1958, the public lately has begun to borrow more freely. As a result, total consumer credit in January, on a seasonally adjusted basis, rose by more than $600 million, an annual rate of over $6 billion, and a new high.

As to demand for long-term capital, the recent slackening is likely to prove short-lived. Indeed, according to several keen observers of the capital market, demand for long-term funds this year is bound to outrun the supply. Thus, Salomon Brothers and Hutzler, a leading bond house, estimates the gap between supply and demand at $1 billion, or roughly 4%. By the same token, the Bankers Trust Company, which approaches the problem somewhat differ-

ently, projects total demand for investment funds at $32 billion for 1959, against a flow of funds to institutional investors of only $25.4 billion. All hands agree that a greater volume of mortgage money will be called for this year, a view which is shared by the Federal Home Loan Bank Board. According to the FHLBB, the total of home mortgages recorded this year should exceed $29 billion, compared with $27.1 billion last year and the previous peak of $28 billion, reached in 1955. Of this sum, nearly $20 billion would be new money, against $18.5 billion in 1958.

The underlying trend, in sum, plainly is toward higher rates. So plain, indeed, has it become that even the Federal housing agencies, which generally tend to lag in such matters, lately have had to recognize it. Thus, effective March 2, FHA amended its rules to raise the interest rate on Section 803 (Capehart housing) loans from 4-1/4% to $4\frac{1}{2}$%. Even Congress is aware of what is taking place. In a surprising reversal of policy, both the House and Senate show signs of approving an increase in the ceiling on VA home loans from 4-3/4% to 5-1/4%. This change is one of the few sensible provisions of the controversial Housing Act of 1959, which is now bottled up in the Rules Committee of the Lower Chamber.

The measure contains several other hikes in rates, notably, in the Senate version, an increase from $4\frac{1}{2}$% to 5% (with authority for FHA to go to $5\frac{1}{2}$%) on Section 207 (regular multifamily housing), Section 213 (management-type cooperatives), and Section 803 (military housing) mortgages. In addition, while the Senate bill would not change the basic 5% rate on Section 213 (sales housing), it would authorize the Commissioner to up the rate, if necessary, to 6%.

The fate of these provisions, like that of the housing legislation as a whole, remains highly uncertain at this writing. However, they do suggest that a certain amount of badly needed realism with respect to the workings of the mortgage market has found its way to Capitol Hill.